A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Tuesday, September 13, 1960, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Balderston
Mr. Bopp
Mr. Bryan
Mr. Fulton
Mr. King
Mr. Leedy
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Szymczak

Messrs. Leach, Allen, Irons, and Mangels, Alternate Members of the Federal Open Market Committee

Messrs. Erickson, Johns, and Deming, Presidents of the Federal Reserve Banks of Boston, St. Louis, and Minneapolis, respectively

Mr. Young, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Thomas, Economist
Messrs. Brandt, Eastburn, Hostetler, Marget, Noyes, and Tow, Associate Economists
Mr. Rouse, Manager, System Open Market Account

Mr. Koch, Adviser, Division of Research and Statistics, Board of Governors
Mr. Knipe, Consultant to the Chairman, Board of Governors
Mr. Keir, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors

Messrs. Ellis, Ratchford, Mitchell, Jones, and Rice, Vice Presidents of the Federal Reserve Banks of Boston, Richmond, Chicago, St. Louis, and Dallas, respectively

Mr. Garvy, Adviser, Federal Reserve Bank of New York
Mr. Parsons, Director of Research, Federal Reserve Bank of Minneapolis
Mr. Lynn, Assistant Vice President, Federal Reserve Bank of San Francisco
Mr. Holmes, Manager, Securities Department, Federal Reserve Bank of New York

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on August 16, 1960, were approved.

Before this meeting there had been distributed to the members of the Committee a report of open market operations covering the period August 16 through September 7, 1960, and a supplementary report covering the period September 8 through September 12, 1960. Copies of both reports have been placed in the files of the Committee.

In supplementation of the written reports, Mr. Rouse made the following comments:

Open market operations in the period since the Committee last met were complicated, as we had expected, by the changes in Regulation D affecting vault cash at all member banks and reserve requirements in the central reserve cities. Some part of the vault cash released appears to have become lodged unused in country banks, and, as a result, the higher statistical level of free reserves that has prevailed since August 25 may be misleading as a measure of reserve availability in the banking system. Under these circumstances, we have had to rely to a very considerable extent on the condition and feel of the money market. Here matters were complicated by the fact that the very heavy inventories of the Government securities dealers were a significant influence making for somewhat tighter conditions in the money market. It did not appear appropriate to flood the market with funds mainly to accommodate dealer financing needs, but the Account Management had to be alert to prevent the pressure from this source from becoming too great. Consequently, reserves were supplied to the market in some volume from time to time by means of repurchase agreements.

With dealer inventories of Treasury bills at a high level, with the failure of any broad demand for bills to develop during the period, and with the beginning of corporate liquidation of bills to meet September dividend and tax needs, which are expected to be greater this year than normal because of the absence of a September tax anticipation bill, bill rates have moved higher during the period. In yesterday's auction, for example, the average rate on the three-month bill was established at 2.65 per cent, 37 basis points higher than the rate established in the auction just prior to the last meeting of the Committee. The average rate on the six-month bills, at 2.916 per cent, was up 29 basis points from the earlier period.

The period immediately ahead does not appear too much easier as far as the conduct of open market operations is concerned. The Treasury advance refunding, of course, suggests an even keel as an appropriate policy, but with the statistics of free reserves still an uncertain measure of reserve availability, there are bound to be problems. I should also like to point to the fact that estimates of the bulge in free reserves anticipated earlier for the next two statement weeks have been considerably reduced since the last meeting. This has been due in part to the accelerated gold outflow. Between now and September 20, $120 million in gold purchases have already been arranged for foreign accounts, and this is absorbing a corresponding amount of bank reserves.

The Treasury bond market has been preoccupied for some time with the possibility that the Treasury would undertake an advance refunding of the wartime "tap" issues. With the Treasury's announcement on Friday, this possibility became a reality, and the market yesterday was seeking to digest and evaluate the terms of the offering. As you know, the Treasury is offering three issues of 3-1/2 per cent bonds in a non-taxable par-for-par exchange for the four earliest dated "tap" bonds. The details of the exchange are familiar to you, and I think that it is obvious that the aims of the operation--to gain a significant extension of debt maturity and to enable the Treasury to hold on to its customers for long-term securities--are of prime importance for the System. The Treasury has done a great deal of advance preparation for this admittedly complex operation--particularly in the way of preparing explanatory material for public consumption--and it can only be hoped that this will pay off in terms of a significant public response. As part of this effort, as you know, Undersecretary Baird and his associates will preside at three public meetings--to which investors, Government securities dealers, and the press have been invited--scheduled for tomorrow in New York, Chicago, and

San Francisco. With the books open until September 20, it will be some time before any judgment concerning public response can be made. The market was busy yesterday trying to establish trading levels for the issues concerned, and although there was virtually no activity reported, the price adjustments were about as expected. The longer-term issues adjusted downward in price by as much as one point in the case of the 3-1/2's of 1990, the key issue, and upward in the 2-1/2 per cent "tap" issues involved by about 1/4 to 1/2 point. As a result, the new issues were trading at prices very close to those of the 2-1/2 per cent "rights." The general reaction seemed to be favorable.

The System Account holds approximately $650 million of the "tap" bonds that are eligible for the advance refunding. I do not recommend that the System participate in the advance refunding.

Mr. Balderston inquired of Mr. Rouse what in the latter's judgment had happened to the reserves introduced into the country banks by the recent vault cash action, to which the latter replied that the banks apparently were just not using them. The figures indicated fairly clearly that there must be free reserves in the country banks, but there was no evidence that the reserves were filtering back to the money market in any major way. The result had been free reserves averaging $300 million during the period since the last Committee meeting, with the figure a good deal higher at times.

Mr. Erickson inquired whether the lag appeared to be greater than when vault cash was released previously, to which Mr. Rouse replied that he did not think so. He recalled that last year quite a long period of adjustment was involved.

Thereupon, upon motion duly made and seconded, the open market transactions during the period August 16 through September 21, 1960, were approved, ratified, and confirmed.

Mr. Noyes presented the following statement with regard to the economic situation:

There is a good chance that the most surprising bit of economic news to appear this week will be the announcement on Friday that the Board's index of industrial production for August was 109. Those who read beyond the headlines will discover that there was still a one point decline from July to August, because the index for the former month has been revised upward from 109 to 110. Taken altogether, however, this news constitutes a much more favorable picture of industrial activity for July and August than has generally been assumed.

If the week is typical of its predecessors in September, most of the news will be much less favorable. In fact, one of the most encouraging things that can be said about the economic situation is that markets generally, and the stock market in particular, have not been stampeded by the bearish news and sentiment that has been so prevalent in the past few weeks.

The most disturbing aspect of recent developments is that we are beginning to see, really for the first time, some signs that the rising trend of consumption expenditures, which has maintained gross national product thus far in 1960, may be coming to an end. Both the immediate and secondary repercussions of such a shift could be serious in the light of the apparent absence of strength in other sectors of the economy. Certainly, if final demand by consumers is not strong, we can expect little independent strength in investment expenditures in the remainder of the year. In fact, only Governmental expenditures now appear to offer a reasonably certain prospect of increase in the period immediately ahead, although one may hope that net exports will increase moderately.

Such a situation would almost certainly have some cumulative effects--that is to say, a softening in the vigor of final demand would cast doubt on the inventory position in many lines and probably lead to further downward revision of plant and equipment spending plans.

Doubts as to whether the uptrend in final demand will be sustained are enhanced by the less than seasonal improvement in employment reported for August and by a cut-back in overtime work at premium rates. In Canada, where economic events seem to have been running a little ahead of those in the United States, the increase in unemployment to a post-war high of 7 per cent casts a foreboding shadow.

Leading business cycle indicators appear to have continued their downward trend in August and, whereas six of the nine major coincident indicators were rising in May, six were falling in July; and the prospects are that when the data for August are all in the proportion declining will increase further.

One interesting element in the recent behavior of our statistical data is that series denominated in dollars have generally declined more than series measured in physical terms. This suggests that the prices at which transactions are actually being consummated are lower, even though the official indexes have been stable, or up in some cases. If this is true, it would add support to the thesis, which is gaining acceptance, that the economy has already made a number of the important adjustments that are ordinarily associated with a moderate recession in business activity, and that with the benefit of hindsight we may find 1960 was a year of moderate recession, and that 1961 will be one of recovery. The substantial inventory adjustment which has already occurred, the absence of any boom in plant and equipment expenditures, and the almost incredible fact that, despite all the upward biases associated with wages, hourly earnings of production workers actually declined from January to August, are all cited in defense of this analysis. Its proponents also find comfort in the atypical behavior of many of the financial series, especially business loans at city banks.

To these observations I might add one of my own. In our frequent review of current and prospective economic developments, I think we sometimes wear out some important observations before we have felt their full effect. I believe the huge shift in the economic impact of the Government's fiscal operations is a good example. In the fourth quarter of calendar 1959 we had a cash deficit of about $4-1/2 billion, and in the second quarter of 1960 we had a cash surplus of about the same amount. The fact that some of this shift was seasonal does not prevent the impact on the economy from being very real. While it may over-dramatize the matter to put it in these terms, when we relate this shift to GNP magnitudes, which are expressed in annual rates, the Federal Government was spending more than it was taking in, in the fourth quarter of 1959, at an annual rate of $18 billion, and taking in more than it was spending at an annual rate of $18 billion in the second quarter of 1960. Thus, the shift can be expressed as a magnitude in the neighborhood of $36 billion at annual rates and, indeed, suggests that the economy may have already made a more massive adjustment than is generally appreciated.

Perhaps this line of thinking proves only that Americans are incurable optimists, but there is some historical precedent for "sidewise movements" that were fully recognized as "recessions" only in retrospect.

In summary, the relative merits of the somewhat conflicting viewpoints I have discussed seem to be of minor importance for monetary policy at this juncture. Whether we are well into and perhaps on the way out of a mild recession, or on the verge of a more serious one--a credit policy designed to give every reasonable encouragement to business and consumer expenditures in the period immediately ahead would seem appropriate.

Mr. Koch presented substantially the following statement with respect to financial and credit developments:

On balance, data becoming available on financial markets in recent weeks have been as bearish as those on economic developments. Both bank credit and monetary expansion, which gave us cause for hope and cheer in July, were disappointing in August. The pace of new security financing has moderated, and common stock prices are back down to their summer low. The rise in consumer credit had slowed markedly in July.

Taking a closer look at commercial banking developments, the loan demand, particularly on the part of business concerns, has slackened further, and business loans are generally quite a good indicator of broader business trends. Seasonal borrowing by commodity dealers, food processors, and trade concerns, which usually begins in late July or early August, has been slow in developing this year. Moreover, concerns like public utilities and consumer finance companies have been repaying bank debt with the proceeds of longer-term financing.

One encouraging note, however, is that in August commercial banks held on to the new Treasury securities they acquired in July in greater volume than they have done after other recent financings. Another encouraging banking development over the past month or so is that the effects of an easier monetary policy are apparently beginning to take hold at the smaller banks, a development about which we were having some concern earlier in the spring and summer.

Turning to the reserve position of the banking system, of the $700 million or so of reserves supplied to member banks by the Federal Reserve over the past few weeks through reserve requirement actions, about $300 million were absorbed through market forces and approximately another $300 million through offsetting open market operations, leaving about $100 million to be reflected in a somewhat higher free reserve balance. Despite higher free reserves, however, the bank reserve positions of the city banks were under somewhat more pressure since the last meeting of this Committee than earlier.

This is suggested by rising money market rates, a somewhat higher level of member bank borrowing from the Federal funds market and the Reserve Banks, the hovering of the Federal funds rate at the discount rate, and the general need of Government security dealers to scurry around for needed financing. This situation of somewhat more pressure with higher free reserves is explained by the fact that the more than $300 million of reserves made available to country banks in late August through the release of vault cash permeated through the banking system quite slowly, a fact highlighted by the virtual absence of the usual flow of excess country bank reserves to the money centers last week at the end of the country bank reserve computation period.

Recent money supply developments have been as disheartening as those in bank credit. The daily average money supply outstanding in August, our new series and a more meaningful one than the last-Wednesday-of-the-month, single day series, was only about $300 million above the recent low reached in June, indicating that part of this summer's earlier increase was offset last month. The last-Wednesday-of-the-month series showed a small further increase in August.

In contrast to the recent course of the money supply and demand deposits, time and savings deposits at commercial banks held by domestic holders throughout the country as well as by foreigners have grown this summer at an exceptionally rapid rate. This rise no doubt has reflected the relatively more favorable rates currently being paid on time deposits than on alternative investment outlets.

Most types of interest rates have shown comparatively little change in recent weeks, although short-term Treasury rates have risen almost one-half a percentage point. On the surface, this is surprising in view of the numerous credit easing actions of the System during this period. It no doubt reflects the fact that business corporations, and other private investors as well, are not as interested in Treasury bills at current rates and because they have other pressing cash needs. The banking system also still does not feel itself liquid enough to absorb substantial additional amounts of Government debt with a still uncertain seasonal borrowing demand in the weeks ahead.

Turning to the reserve projections for the next few weeks, let me point out again the change that was made in the reserve pattern table last time and which has been continued in a somewhat modified form this time. You will notice that in the two columns on the right of the table alternative projections are set forth. The second column from the right projects the level of outstanding free reserves on the same basis as we have in the past, namely, assuming no further System open market operations and only taking into account seasonal market forces, including an allowance for seasonal changes in the money supply but no growth. The second alternative, in the column on the extreme right, shows a projection of outstanding total reserves assuming System open market operations will take care of all seasonal market needs, thus maintaining the current level of free reserves. The volume of System operations that would be required in the future to achieve this second alternative is shown in the third column from the right.

The purpose of the addition of this total reserves alternative to the pattern table is to give both the Committee and the Manager of the Account a broader statistical base upon which to formulate policy and action. It is not meant as a substitute for, but rather a supplement to, the other information that is supplied. I tend to agree with what I read to be the views of Mr. Noyes as expressed at your last meeting, namely, that if a single measure is to be selected as the most appropriate indicator of the effectiveness of current monetary policy, it might rather be the money supply itself than the reserve base underlying it. In my view, too many factors like the volume of Government and interbank deposits which have little relationship to economic affairs affect total reserves, whereas the privately-held money supply is more relevant to the course of spending.

I also retain the belief that the free reserve concept can be a useful indicator to the Manager of the Account in helping him achieve the monetary policy objectives of the Committee, if, but only if, the effect of changes in reserve availability on such more fundamental financial measures as bank credit expansion, the money supply, and interest rates are under constant watch.

Today's pattern table shows that the average level of free reserves in the week ending tomorrow will approximate $435 million. Next week, assuming no offsetting System action, it would likely average around $750 million. In the following two weeks the estimates of the Board's staff drop to $470 and $5 million, while those of the staff of the New York Bank are approximately $300 million higher in each of the two weeks due to differing estimates of the decline in the midmonth float and the change in required reserves. Regardless of one's views as to the likely course of free reserves in the coming weeks, I should like to suggest for the Committee's consideration that it instruct the Manager of the Account at this meeting, as I understand it did at the last meeting, that not too much emphasis be placed on the level of free reserves and more be placed on the feel and tone of the market.

This is a period when seasonal demands for liquidity are normally very high, for example, corporate cash needs for dividend disbursements and tax payments. Moreover, the sharp rise in reserve availability will be due mainly to a temporary midmonth bulge in float, the effects of which, if I remember the record correctly, the Committee has felt should not be offset, at least fully, by open market operations. Finally, our reserve projections are particularly tenuous now since we have to estimate the amount of vault cash allowable as reserves.

Therefore, I conclude that there is much to be said, particularly in view of the uncertain economic situation and the recently announced Treasury refunding program, for permitting the level of free reserves over the next two weeks to remain above recent levels. Indeed, if the economic situation shows a seasonally adjusted downward drift in the coming weeks, as the accumulating evidence suggests it might very well do, it would be the part of wisdom to be thinking of further gradual credit-easing actions.

Mr. Marget commented as follows with respect to the United States balance of payments:

The gold outflow continues. As I reported at the last meeting of this Committee, in July the gold outflow amounted to over $175 million, as against only $125 million for the whole of the first six months of this year. In August, the figure was $140 million. Thus far in September, the figure for actual gold purchases by foreigners has been only $15 million; but, as Mr. Rouse reported, we have received notice of additional purchases of $121 million to take place within the next ten days, so that, even if we receive no further orders in September, net gold purchases by foreigners in the current month will be about as large as in August.

Unfortunately, another thing that is continuing is the giving of wrong explanations for the gold outflow. As recently as August 24, for example, the Financial Times of London solemnly declared that what "is at the root of the recent resumption of the gold outflow" is "the growing mistrust of the dollar in official circles outside America." If this were true, then, in view of the more than $9.5 billion of official foreign dollar balances (to say nothing of the more than $7.5 billion of private foreign dollar balances) outstanding, our position would be a very serious one indeed. We should in fact be confronted by the kind of immediate policy dilemma which might very well not only deprive us of all flexibility in meeting the requirements of the current domestic situation, but also force the adoption of policies exactly contrary to those required by the domestic situation.

No one can say with absolute certainty that such a situation will never arise. What one can say with certainty, however, is that the evidence up to date is categorically against the interpretation of our recent gold outflow which I have quoted from the Financial Times. As I suggested at the last meeting of this Committee, the place to look for evidence is in the total of foreign dollar balances. If these dollar balances were to decrease, say, in an amount equal to the amount of gold outflow, one could regard this as prima facie evidence of a conversion by foreigners of existing dollar balances into gold; and it might not be unreasonable, under such circumstances, to speak of evidence of "growing mistrust of the dollar in official circles outside America." But it is certainly unreasonable to draw this conclusion, if, instead of foreign-owned dollar balances decreasing, they increase. As I reminded the Committee at its last meeting, this is exactly what happened during the whole period of gold outflow from 1958 through June of this year. At the last meeting, I could not make a categorical statement as to what had happened since June because the figures were not then available. They are available now for July; and they show that during that month foreign-owned dollar balances, instead of decreasing in proportion to the $175 million of gold outflow, actually increased by around $325 million. We do not yet have the complete figures for August; but if the figures for foreign holdings at the Federal Reserve Bank of New York can be taken as an indication (they show a rise of around $350 million), we may expect a comparable increase for the month of August also. In the light of these figures, it simply makes no sense to suggest that the recent gold outflow is to be taken as evidence of "growing mistrust of the dollar in official circles outside America."

But it would also not be sensible to suggest that these figures I have just given can be accepted with complacency. Gratifying as it is to see the evidence of continued confidence in the dollar which is represented by these large increases in foreign dollar holdings, it is also true that we should all be feeling more comfortable if these foreign dollar holdings hadn't increased so much. Indeed, given the sizeable gold outflow that began in July, we should have been quite happy if they hadn't increased at all. For what we must keep reminding ourselves of is that the figure for gold outflow plus the increase in foreign-owned dollar balances is a rough measure of the size of the over-all deficit in our balance of payments. For July, that total figure was as much as $500 million; the figure for August will also probably turn out to be quite large; the result, therefore, will inevitably be that the published figure for the over-all deficit in our balance of payments for the third quarter of this year, instead of showing the improvement which had generally been expected, will show what will look like a deterioration.

What, in fact, has been happening?

It is of the first importance, I am convinced, to understand that what has not been happening, so far as our evidence goes, is a deterioration in our trade position. On the contrary, the latest figures we have (for July) show that while our imports have remained at about the same level (around $15 billion, annual rate), our exports, which had been averaging a rate of about $19-1/2 billion during the second quarter, moved up sharply above $20-1/2 billion. One should never put too much weight on the performance in a single month. But much more is involved here than the performance of a single month. It will be remembered that in the spring of 1959 our trade surplus was around zero. It will be remembered, also, that it was this very serious deterioration in our trade position which gave rise to widespread concern as to our ability to maintain a competitive position in world markets. A rise in our trade surplus from around zero a little over a year ago to its present position of a surplus of around $5 billion is a development that goes far beyond the expectations of most of those who have been concerned with forecasting the course of our balance of payments; and considering that it is the field of trade which reflects directly the concerns of those who have been most troubled about our balance-of-payments prospects ("Have we priced ourselves out of the market?", "Is our wage-level too high?", "Have we slipped in terms of innovations of technique?"), this trade performance, taken by itself, is anything but discouraging.

But, of course, in speaking of the balance of payments, we cannot take the trade performance "by itself." We can say, with assurance, that what will generally be referred to as the "deterioration" of our balance of payments which set in in July was certainly not the result of a deterioration in our trade position. But this means that we must look further for the explanation, and we must look particularly into the field of capital movements. Fortunately, we now have some figures on these movements for the month of July, and can offer some general observations which were not possible as recently as a week or so ago.

The first of these observations is that we now have evidence of a substantial outflow of funds reported by United States banks, either for their own account or for that of their customers. The evidence is contained in the item "claims on foreigners" as reported by banks in the United States. In July, this item, which had increased by only $220 million in the whole first half of 1960, rose in July alone by $305 million.

The second observation is that the data not only provide no real evidence of a "flight from the dollar" by Americans, but also provide no real evidence of net movements of United States funds for "speculative" reasons. (For example, there was no increase in claims on those countries most often cited as havens for speculative funds--namely, Germany and Switzerland; and it is worth noting, also, that in spite of the reported movements of Belgian funds into Switzerland as a result of the Congo troubles, the fact that Belgian private dollar holdings rose in July by $40 million would suggest that the United States also may have been regarded as a haven for funds previously invested in the Congo.) The outward movement of United States bank funds in July is to be explained not as a speculative movement but either by reference to special transactions with which we are familiar (for example, about a third of the total rise in claims--$110 million--represented the extension of credits to Venezuela) or by the operation of normal market processes.

Of these "normal market processes," the one that interests us most is of course the shifting of funds in response to interest rate differentials. The fact that of the two-thirds of the outflow that did not go to Venezuela, one-half (that is, another third of the total) went to Canada and the United Kingdom, and the other half went to Japan and a few other countries for export financing by bankers' acceptances, would suggest that interest-rate differentials played a major role in these movements.

This, surely, was to be expected as part of the normal functioning of the international monetary mechanism. It is equally to be expected that this part of the movement of funds will reverse itself whenever the international structure of interest rates changes in a direction and a degree sufficient to make such a reverse flow profitable. (Since I mentioned Canada as a country to which a considerable amount of funds seems to have moved in July, it is worth noting that since late August there has been a slight covered-interest-differential in favor of shifting funds from Canada to the United States.)

It is clear, I hope, that all this is very far from amounting to a suggestion that our balance-of-payments troubles are over. For one thing, gratifying as our trade performance has been, it could be nullified by the assumption by the United States of new foreign aid commitments of an extent and character that would condemn us to a race in which the improvement in the trade picture would always fall short of what is required to balance our international accounts. But the hope, surely, must be that in this field, as in others affecting our balance of payments, our actions will be of a degree of responsibility sufficient to convince both the foreign holders of dollar balances and the American financial community itself that our policies are such as to deserve a fair trial while we are working our difficulties out, instead of being such as to deprive us of all flexibility in our efforts to cope with these difficulties.

Mr. Hayes presented the following statement of his views on the business outlook and credit policy:

The sideways movement of the economy continues, characterized by a high level of activity, very little growth, substantial unused resources, and considerable price stability. The chance of a break-out on the up side is growing increasingly remote. On the other hand, normal seasonal factors, including production of the new automobile models, will provide some expansionary influence in the next few months; and this should help counter any tendency toward recession for the remainder of the year.

Discouraging elements in the outlook include the latest SEC-Commerce survey which indicates a leveling off of plant and equipment expenditures in the third and fourth quarters, doubtless due in good part to the current squeeze on profit margins; the accumulating evidence that residential construction is suffering from a basic weakening of demand; the recent sluggish showing of consumer spending, especially in the area of consumer durables; and the latest data on unemployment.

The significance of inventory developments in the last few months is not wholly clear. Although businessmen have succeeded in holding down inventories of purchased materials, lagging sales have brought an increase in manufacturers' inventories of finished goods and goods in process--as well as total manufacturers' inventories and the ratio of such inventories to sales. Statistics for July, however, show the first drop in manufacturers' inventories in many months, whereas in the preceding months they had merely increased at a reduced rate. Perhaps the drag which the economy has been experiencing from a decline in the rate of inventory accumulation is drawing to an end.

The stagnation of industrial production since the beginning of the year seems attributable perhaps to declining inventory demand, the increasing proportion of consumer expenditures absorbed by services, a somewhat higher proportion of savings in relation to personal income, and the virtually unchanged level of Federal expenditures. While it is too early to attempt to forecast the direction of the next major move of the economy, we should perhaps be making a start toward considering possible courses of action in the event that this move should be downward.

As for credit developments, business loans of weekly reporting banks in August continued the below-normal trend of July, as did total loans. While investments did not rise as rapidly as in July, the gain was still sufficient to bring a change in total bank credit about in line with the seasonal pattern. The money supply rose only very moderately in August, but our policy of ease appears to have brought results with respect to bank reserves. Total reserves, nonborrowed reserves, and required reserves each averaged higher in August than in July on a seasonally adjusted basis. Nonborrowed reserves should soon approach the all-time 1958 peak.

The System has taken a number of steps in the direction of monetary ease to meet current economic conditions. Probably the full effects of some of these measures have not yet been felt. In view of this, plus the fact that the economic situation appears to be essentially unchanged since the last Committee meeting, a further easing of credit policy would not be appropriate at this time. This would be true wholly apart from the obvious need to preserve an "even keel" during the current Treasury advance refunding. In my opinion the directive and the discount rate should not be changed.

As for open market operations, I think that present policy should be continued, with doubts being resolved on the side of ease. It seems to me that statistics on free reserves will be an even less reliable guide than usual in the coming weeks, since it is quite uncertain to what extent released vault cash will actually affect bank behavior. September will be marked by the seasonal pressures associated with the tax date and especially by the prospect that pressure on the dealers, already considerable, will increase as the dealers are called on to play their usual role of taking Governments off the corporations' hands to provide funds for taxes, dividend payments, or other seasonal needs. With their portfolios already so heavy, the dealers are not in nearly as favorable a position to perform this function as we might desire. In this context the Manager should, I believe, be given more than usual leeway to adjust to the feel of the market; and he might wish to give special attention to the relationship between bill rates and the discount rate as a measure of market pressure. It may well prove to be unnecessary to offset fully the market factors expected to bring a sharp bulge in free reserves in the next two weeks, particularly as additional reserves will be required in any case a little later in the year.

I am sorry to say that the most recent figures do not indicate any over-all improvement in the balance-of-payments situation. In fact, the acceleration of foreign central bank purchases of gold from the Treasury--which we have already begun to see--may well become an increasingly significant factor affecting member bank reserves over the remainder of the year. With gold selling in London and Switzerland at about $35.25 an ounce yesterday, it is no longer attractive for central banks to buy gold abroad. If this price situation continues, foreign central bank purchases of gold will tend to be concentrated on the United States gold stock.

If, as seems to be the case, the economy is in a more or less neutral and uncertain area between expansion and recession, I would think that the Board might wish to consider a further reduction of margin requirements in the not too distant future, perhaps to what has come to be considered a "normal" level, i.e., 50 per cent.

We need not try to reach any conclusions now as to what our policy should be if the economy continues to stagnate over a prolonged period or begins to show a recessionary trend. But I think it quite possible that, if such tendencies develop, we should seriously consider to what extent fiscal policy should be called upon to share with monetary policy the burden of encouraging greater business activity.

Mr. Johns said that in view of the clear and forthright appraisal of business and monetary developments that had already been given, he would be brief in his own comments. Four weeks ago, he recalled, he had expressed some gratification at the appearance of a turnaround in the total reserve situation, and hopefully in the money supply. However, subsequent developments had been disappointing. Although in the two weeks ended September 7 free reserves averaged $337 million, the highest level of the year, at the same time there was a smaller amount of effective reserves and also a smaller money supply than at the beginning of the year when, instead of free reserves, there were net borrowed reserves of around $300 million. In his opinion straightforward action was needed to bring about the expansion of bank credit that had been the objective of the Open Market Committee, as expressed in its directive, since May. Accordingly, he suggested that the Committee, as expeditiously as possible, bring total reserves up to about $18.8 billion, which on a seasonally adjusted basis would mean an increase of perhaps 3 per cent. Thereafter, he felt that the Committee should be thinking in terms of an annual rate of increase of some 4 or 5 per cent. He did not believe, in view of economic developments, that the System could defend a failure to take such steps as might be needed to bring about expansion of the money supply.

Mr. Bryan said it seemed to him quite clear that the economic situation was deteriorating currently. While a variety of hypotheses could be made to the effect that there had been a recessionary period from which the country would come out sharply on the upside, the probabilities were not in that direction. In the circumstances, he disagreed with the view of Mr. Hayes that no further monetary ease was required or would be appropriate.

As he saw it, Mr. Bryan said, Committee policy had been decidedly inadequate. If one looked at August of last year and adjusted total reserves to allow for the change in reserve requirements, he would come out with a daily average of $18,486 million, or approximately that figure. This August, when the Committee presumably was trying to ease, one would come out with a daily average adjusted for the change in reserve requirements of $18,374 million. Thus far in September the daily average of total reserves was $18,398 million, whereas in September last year, adjusted for the change in reserve requirements, the figure was $18,466 million, so that again the figure was lower. Accordingly, in a period when, according to the directive, the Committee was trying to provide a basis for credit expansion, the total ability of the banking system to support an expanded money supply was less than last year when the System was trying to bring about exactly the opposite results.

Mr. Bopp said that Third District business activity continued at a fairly good rate, but with no indication of further increase. While consumer demand remained reasonably high, manufacturing and construction activity had declined. Unemployment in major areas of the District declined on balance in July, thus narrowing somewhat the unfavorable gap between the District and the country as a whole. However, despite reductions in unemployment in Philadelphia, the Lehigh Valley, and several anthracite areas, the average rate was still 6.4 per cent.

Mr. Bopp went on to say that in the period since the most recent Committee meeting there had been no significant movement in the earning assets of District banks. However, there had been a significant relaxation of pressure on reserve positions. Although there was still some borrowing in the form of Federal funds, it was substantially less than it had been. The reserve city banks had not been borrowing from the Federal Reserve Bank.

With reference to Mr. Rouse's comment on the failure of reserves made available to country banks by the recent vault cash action to come back to the money centers, Mr. Bopp said a study of country bank borrowing at the Philadelphia Reserve Bank showed that thus far this year 183 banks had borrowed, and that 107 of those banks borrowed at times when their excess reserves were greater than the amount of the borrowing. In some cases particular banks borrowed for as much as ten periods, and in seven cases those banks would not have had to borrow. The Reserve Bank had now distributed a worksheet to country banks which would enable them, if they followed it, to check on their reserve position and thus make more efficient use of their funds.

After commenting on the unusual volume of remittance float in the Third District occasioned by the Pennsylvania Railroad strike, now settled, Mr. Bopp said that he would not favor a change in the directive or in the discount rate at this time. In view of Treasury refunding he would maintain an even keel, with as much assurance as possible that no tightness would develop.

Mr. Fulton reported continued deterioration in the economy of the Fourth District. While the consumer was continuing to buy, and department store sales were 2 per cent above last year, auto sales were down considerably and in practically every other category activity was lower than it had been. Unemployment was up contraseasonally. In the heavy machinery industry backlogs were disappearing and new orders were just not coming in. There was an increase in steel orders in August as compared to July, but in September orders again receded and the industry was now living on expectations. The operating rate was low, having declined about 11 per cent in the past couple of weeks. It was hoped that the automotive industry would come in with orders incident to stocking dealers with new cars, but in view of the backlog of unsold cars the extent to which inventories of new cars would be created was problematical. While the industry reportedly was anticipating a good year in 1961, compact cars were expected to comprise about 40 per cent of all units manufactured and they take about 20 per cent less steel than full-sized cars. Accordingly, even if production were about the same as this year, that is, around 6.5 million cars, the requirements for steel would be less.

Mr. Fulton said that in many areas there had been cutbacks in plant and equipment expenditures. Moreover, in many cases the programs that were going ahead had tags attached to them in the form of items that could be eliminated if the economy seemed to be continuing at the same level, with no uptrend. Currently, operating rates were low and capacity was available to supply almost anything on short order. With wage increases inevitable because of existing contracts, the existing squeeze on profits, already affecting all segments of industry, seemed likely to become more acute.

Mr. Fulton said he was pleased that the Desk had not stuck too closely to the free reserve figure and had given recognition to the fact that excess reserves were concentrated in the country banks. He saw the situation as a counterpart of the situation in 1954 when there was a considerable time lag before reserves in the country banks came into use. It was his opinion that the Desk should give minimum significance to the free reserve figure and pay attention principally to the feel of the market and the action of short-term rates, including the rate on Federal funds, which had been close to the discount rate most of the time. While there had been free reserves in the Fourth District, they had been lodged in the country banks; the reserve city banks had been under pressure constantly, with negative free reserves. In his view, therefore, an increase in the money supply was of paramount importance and further relaxation by way of open market operations would be quite appropriate. He would not favor changing the directive or the discount rate at the present time.

Mr. King indicated that he shared the concern of those who had spoken about the money supply and the failure of the general reserve picture to show more improvement. However, the purchase of Government securities by so many people and the increase in time and savings deposits at banks were factors affecting the money supply that should be recognized in order to view the situation in true perspective. As he had said, he was concerned, but not to the point of feeling that drastic action should be taken, for he did not believe that the things affecting the economy today were going to be cured by easing the reserve position of the banks unnecessarily. Instead of producing the results that were desired, such action would be more likely to have repercussions affecting the balance-of-payments problem that was of so much importance at the present time.

Mr. King said he would not favor changing the present directive. He had voted against amending the directive at the August 16 meeting because he felt that the consensus did not contemplate open market operations consistent with the change in clause (b) that had been proposed. However, he was not disposed at this time to recommend going back to the previous directive, and he would vote to continue the outstanding directive on that basis. He would favor no change in the discount rate at this time. Like Mr. Fulton, he believed the Committee must leave it to the Desk to manage the Account largely according to the feel of the market. Since such an expression leaves the Desk without too much guidance, he would say that the feel of the market he had in mind was one of relative ease.

Mr. Shepardson said the appraisals of economic activity that had already been given were in line with his own appraisal. Certainly no vigorous upturn appeared to be imminent. In view of his long-run concern for growth in the money supply, and the fact that such growth had not been achieved, he felt the Committee should use this opportunity to do more toward trying to provide for some of that growth. Accordingly, although he would not want to create an unduly easy position, he would provide needed reserves freely at this time and make allowance for the lag in effectiveness of the action on vault cash. He would not be too much concerned about float bulges; his objective would be to maintain a position of relative ease that would encourage and be conducive to growth in the money supply.

Mr. Shepardson commented that the present directive indicated, in essence, what the Committee has been aiming at for several months. Accordingly, he saw no reason for a change. In his opinion the Committee had not been as effective as it might have been in achieving the objectives indicated by the directive, and he would favor moving further in that direction.

Mr. Robertson said that in view of the state of the economy he had sympathy with the views expressed by Messrs. Johns and Bryan. However, he did not see that anything could be done at this particular juncture. In view of the Treasury refunding, all that could be done for the present was to maintain an even keel and instruct the Manager to see that no tightness existed. After the financing period, when the opportunity presented itself, he felt that the Committee should move toward further ease in order to give strength and impetus to the directive that had been adopted. In other words, the Committee should move as quickly as it could toward an easier position, but this could not be done during the period of Treasury financing.

Mr. Mills said that as he sized up the economic situation the development of monetary and credit policy would increasingly have to contend with intangible factors with which the System had not been accustomed to deal. Public disappointment in business prospects had created psychological attitudes that, in their impact on the financial and economic factors customarily taken into account in policy making, were producing a condition that was forcing out of the reach of monetary and credit policy the elements that the System ordinarily seeks to control. He would be happy if he could persuade himself that the failure of the released vault cash to permeate into the reserve supplies of the commercial banking system in a manner that would stimulate expansion was the real reason why the Committee had not seen the improvement in the money supply or the type of credit expansion that it had sought to foster. On the contrary, however, he was fearful that contractive financial factors were taking a hold on the economy, that they were tending to feed upon themselves, and that in doing so the contractive factors were putting the economy out of reach of the influence of monetary and credit policy by outpacing the supply of reserves that the System was making available.

Therefore, Mr. Mills said, he was one of those who believed that if the System were to make reserves freely available it was problematical whether those reserves would flower out into credit expansion. He felt that the country might be coming into a situation that would have to run its own course before monetary and credit policy resumed its status as a constructive and stimulating economic influence. Along that line there was the strong possibility that the System would be charged increasingly with the fact that interest rates, particularly at the long end, were at a higher level than many observers would consider conducive to the type of economic situation to which the System should contribute, that is, one calculated to induce capital expansion. However, if the premonitions he held were realized and the country was truly in a seriously declining stage of the business cycle (as pointed out, consumption seemed to be faltering and capital expansion had already faltered), the prospect was that at some future point an impairment would be seen in the credit standing of important corporations that would tarnish the ratings of their securities. As a consequence, a relatively high yield on corporate securities--and possibly in the more distant future on public securities--would be the result of a reduced credit standing rather than a reflection of the influence of monetary and credit policy.

Mr. Leach reported that economic activity in the Fifth District was still beset by divergent trends. On the one hand, both manufacturing employment and total employment were at or near record levels; on the other hand, production, shipments, and sales in several major industries showed moderate declines. Many textile companies had reduced their work week from six days to five, and a few from five to four. For the remainder of the year textile activity would be fairly high, but considerably below earlier expectations. In recent weeks furniture production and shipments had been well below the high levels reached earlier this year, but retail sales had increased somewhat. A few industries, such as chemicals and paper and printing, showed activity above a year ago. Residential housing contruction was at a level substantially below last year, but total construction contracts in a few recent months had been well above last year because of a few large awards. According to present indications, cash receipts from flue-cured tobacco, the District's biggest cash crop, would be about 10 per cent above last year.

Loan demand seemed to continue relatively stronger in the District than in the country as a whole, Mr. Leach said. During the four weeks ended August 31, total loans at District reporting banks rose by 0.7 per cent contrasted with a decline of 1.1 per cent for all reporting banks in the United States.

With respect to policy, Mr. Leach said it was his belief that the state of the economy and the situation in the money market called for slightly more actual ease than had existed during the past three weeks.

He doubted whether this objective could be expressed satisfactorily in terms of statistics. The recently prevailing over-all average of $300 million of free reserves might prove adequate, or it might be necessary to provide more reserves. He realized, of course, that the current Treasury financing called for an even keel policy at the moment, but he would certainly be sure that all doubts were resolved on the side of ease. He would not favor changing the discount rate or the directive.

Mr. Leedy said there was nothing particularly new to report from the Tenth District. There were few plus signs in the District, and as he understood it there were few in the national picture, as far as the economy was concerned. At the August 16 meeting he had felt there was fairly general agreement that the Committee should be moving in the direction of providing more encouragement for the expansion of credit. While the figure on free reserves had shown some increase, the movement in short-term rates, including the Federal funds rate, disturbed him. He had the feeling that in this period, and perhaps in the period ahead, the free reserve yardstick was a particularly unreliable one due to the availability of additional vault cash which, at the country banks particularly, may not have been taken into account. For the period ahead he believed that the Committee should aggressively inject some additional reserves, since it seemed to him there was nothing to be lost in such a program and everything to be gained. Instead of watching the free reserve figure too closely, attention should be centered more on the level of the money supply, on bill rates, and on the Federal funds rate. In the Tenth District, he was told that many banks had been employing funds in the Federal funds market rather than in the bill market due to the attractiveness of the Federal funds rate.

Despite all of these comments, Mr. Leedy said, he would not favor going overboard and flooding the reserve position of the banks. However, he did feel that the Committee should be moving noticeably in the direction of providing more ease. He recognized that on account of the Treasury financing the System would not be entirely free for a time to make any really overt move. As he understood it, however, the books on the advance refunding would remain open only until September 20, and there was not likely to be any other Treasury financing until after the middle of October. It appeared, therefore, that there would be a period before the next Committee meeting in which some move of the kind he had suggested could be made. Even in the period immediately ahead, it seemed to him that the Desk should be most cautious, in the light of the movement of short-term interest rates, not to permit any tightening of reserve positions to occur.

Mr. Allen said that business news of the past month seemed to be generally regarded as being on the pessimistic side. His own view was that, although developments had not been such as to induce enthusiasm, the current mood could properly be termed one of caution rather than widespread pessimism. While estimates of capital expenditures for 1960 were now less than they had been in March, it should be noted that even on the basis of the lower estimates virtually all major industries would spend more in 1960 than in 1959.

With reference to Seventh District developments, Mr. Allen said that although the steel operating rate for the entire country was around 52 per cent, it was 60 per cent in the Chicago area and 70 per cent in Detroit. The employment situation is less vigorous than in the nation as a whole. However, total employment in Seventh District States was almost exactly the same as a year ago, and Wisconsin was doing better because of strength in industrial equipment industries and Rambler automobiles. Department store sales for the four weeks ended September 3 were just equal to last year in the District, as against 2 per cent above last year for the country. Sears, Roebuck, whose results are usually fairly representative of the total for all retail trade, reported for August a 4 per cent increase in sales over last year.

As to the automobile situation, Mr. Allen commented that the year's low in production apparently came in the week ended August 27, and future schedules seemed high in the light of current sales and inventories. On August 31 new car inventories were 880,000, of which 90,000 were estimated to be 1961 models. Sales of 1960 cars in September were forecast at 350,000, which would mean inventories on October 1 of 450,000 1960's plus 500,000 1961's. The total--950,000--would be a high figure for this time of year.

Demand for bank credit, relatively speaking, had remained weak. For the last three weeks of August, Seventh District reporting banks showed a drop of $50 million in total loans compared with an increase of more than $90 million last year. District banks had continued to liquidate Government securities, as against net additions by all weekly reporting banks in the country, but the situation was due in large part to heavy sales of bills by one large bank that had been adjusting its reserve position. The basic position of central reserve city banks had improved steadily. These banks borrowed nothing at the discount window in two of the three weeks ended September 7, and they had been net sellers of Federal funds for several days. Reserve city and country banks had increased their borrowing in recent weeks, but the borrowing was concentrated at fewer banks. Most of the reserve city bank borrowing was in Detroit and resulted from seasonal deposit reductions by the large motor manufacturers.

Mr. Allen said it seemed to him strong factors were at work that would tend to support business activity and doubtless would eventually mean an upward trend in the economy. These included completion of inventory reduction in a variety of industries, a continuance of vigorous economic activity abroad, rising Government spending on defense and other activities, and easier credit. As at the August 16 meeting, he felt that the Committee had gone far enough in the easier credit area, and he would "stay where we are" for the present. Although he was not critical of what had been done--in fact had supported it--he was concerned that the adjustments which must take place for the economy's long-term benefit were so slow in coming, although he knew that it would be a slow process. Therefore, he would not change the directive, the discount rate, or the degree of ease in money and credit.

Mr. Allen added that the comments he had made were prepared on Saturday and Sunday. He would stand on them, he said, although he was impressed by the views expressed at this meeting by those who differed with him and particularly by Mr. Noyes' suggestion that the adjustments to which he (Mr. Allen) had referred might be occurring more rapidly than he had thought.

Mr. Deming said there was little new to report concerning the economic picture in the Ninth District. As in the nation, the movement was sideways at a high level, with economic plus and minus factors about canceling out. The major plus was the better farm picture, while the major minuses were labor requirement forecasts and reduced residential construction. The Minneapolis employment people expected a less than seasonal decline in unemployment during the balance of this year.

Mr. Deming then summarized a recent poll of Minnesotans on their expectations with regard to general business conditions and their own financial outlook over the next 12 months. In response to a question concerning business conditions, 21 per cent expected them to improve, 63 per cent expected them to hold about the same, and 10 per cent thought they would worsen, while 6 per cent had no opinion. These figures were quite close to those obtained in August 1956, with one exception that perhaps was important. Although only one in ten expected conditions to worsen, this was twice as many as felt that way four years ago. In response to a question on personal financial conditions, one-fourth of the respondents thought they would be better off in the forthcoming year, and another two-thirds thought they would be as well off as at present, these proportions being virtually the same as in 1956.

Turning to the national scene, Mr. Deming expressed concurrence in the tone of the staff report. He felt that conditions were no better and might be deteriorating a bit. Of particular concern were the August unemployment figures and the guesses about GNP for the third quarter. On the financial side, he felt that the System was caught in a difficult situation. The impressive list of easing actions that had been taken by the Federal Reserve had resulted in a lessening of total reserves, although in part this might reflect only a temporary rise in currency circulation over the Labor Day weekend. In part, however, it reflected gold outflow which might well result from easing actions that had led to lower interest rates. Thus, the System might be in the position of the dog chasing his own tail in its attempt to pump up total reserves. Nevertheless, he felt that the System should pursue this goal more vigorously, and he believed this could be done without any strong danger of depressing rates unduly. In fact, it seemed to him that the market had been unduly heavy during recent weeks despite a higher level of free reserves.

Mr. Deming said he would not favor changing the discount rate or the directive at this time. He recognized the necessity of maintaining an even keel during the Treasury financing, but he believed further action could be taken prior to the next Committee meeting without abandoning the even-keel policy. Within whatever bounds it was thought necessary to observe this policy with respect to the advance refunding, he would be inclined to let money market factors be more fully reflected in their actions adding to reserves within the next week or weeks (depending on whether the staff estimates of the Board or the New York Bank proved to be more accurate). To the degree necessary, he would supplement these effects by direct open market operations so as to let total reserves grow and so as to provide a somewhat easier money market climate. He would not be too concerned about what this policy might do to the free reserve figure.

Mr. Mangels said rough figures indicated that of the 144 country banks in the Twelfth District, 40 got no benefit from the recent action on vault cash. Eighty-three benefited less than $50,000, 13 benefited from $50,000 to $100,000, and eight benefited from $100,000 up to $200,000. The reserve city banks gained some $70 million, but more than half of this was at one bank. Evidently the amounts released at country banks were not going to flow into the market very quickly because there was not enough at any one bank to make any particular difference.

Mr. Mangels then referred to a wire he had received regarding the meeting of the Seattle Branch directors last Friday which indicated that the meeting had a pessimistic tone and that each director expressed concern regarding conditions in his particular area. No improvement was expected in the lumber or plywood business, the salmon pack was poor, Spokane business activity was moving sideways with little improvement expected, the apple pack in Washington was threatened by strike, and the number of overdrafts on the books of banks was reported to be large.

Mr. Mangels expressed agreement with those who had suggested that although it would be necessary to maintain an even keel for a few days, as soon as possible it would be desirable to ease quite materially. As a measure of the degree of easing he would contemplate, he mentioned free reserves as high as $500 million or perhaps even a little higher. He would not favor a change in the directive or the discount rate at this time.

Mr. Irons said that his views on the over-all economic situation were quite similar as to those expressed by Mr. Allen. During the past summer economic activity had been on a rather flat level, with pluses and minuses underneath the total, and some progress had been made in accomplishing rather significant adjustments. The psychological attitude that he detected was not one of pessimism but rather one of caution, with perhaps less anticipation of a strong rise in the fourth quarter than there had been earlier but, on the other hand, no anticipation of a sharp decline. To some extent current appraisals contrasted with earlier estimates with respect to plant and equipment expenditures. While these estimates were not being realized, actual expenditures for the year promise to be well above a year ago.

Mr. Irons said that Eleventh District conditions were quite similar in broad outline to national conditions, although the specifics were somewhat different. In general, there had been a rather flat sideways movement with crosscurrents underneath. There was nothing to indicate the likelihood of a strong upward surge, but the same thing was true on the other side also. Without question, banking positions in the District were easier than prior to the shift in monetary policy about three months ago. Borrowing from the Reserve Bank consisted almost entirely of borrowing by country banks for seasonal purposes, with the total running rather consistently at around $10 to $11 million, compared with $25 or $30 million some two or three months ago. None of the city banks were borrowing from the Reserve Bank, and only one city bank was a substantial user of Federal funds. In the past three weeks District banks were net sellers of Federal funds.

In summary, the situation in the District was uncertain, Mr. Irons said, and he could not put his finger on things developing strongly in areas that had pushed the District up in the past. For example, no one was anticipating a great surge in petroleum or in defense spending in the District. On the other hand, no further decline in the petroleum industry was expected.

Mr. Irons said he had been quite satisfied with the operation of the Account during the past three weeks. Developments had worked along perhaps more favorably than might have been anticipated. He was not unhappy about the trend of the bill rate; he had been fearful that it might move down and get quite low but, whatever the reason, that unfortunate development had not occurred. He felt that the situation called for an easier availability of reserves for seasonal purposes and for some moderate expansion, but he did not feel that it called for a policy of pumping reserves into the banking system aggressively because he doubted whether that was the answer to the present situation. Of course, the Treasury refunding period was going to require an even keel for the time being.

Mr. Irons expressed the hope that the short-term rate structure would not move downward so sharply as to complicate the picture further. The problem was one of trying to walk a tightrope between international and domestic problems, and this was difficult. All things considered, he would continue to follow the policy of the past few weeks, which he felt was appropriate and satisfactory. This inferred a somewhat easier availability of reserves, not watching any one figure particularly but watching short-term rates, the demand for credit, the use of Federal funds, and the rate on Federal funds. Under such circumstances, considerable leeway must be given to the Manager of the Account to feel, judge, and appraise the situation as it moved along. As he had said, he would not want to pump additional funds into the banking system aggressively at this time.

Mr. Erickson reported that business in the First District seemed to continue its sideways movement. All of the indices that were ahead of last year were ahead by a slightly greater percentage than nationally; and where minuses occurred, they were not quite as large as nationally. At the August 16 meeting, he had reported that the July survey of mutual savings banks showed a deposit increase in that month greater, when compared with a year ago, than any month since 1957. In August the survey showed the same percentage increase (4.5) over a year ago. Business loans were down, District banks were net sellers of Federal funds in the first half of August and buyers in the last half, and for the month as a whole they were net buyers to a slight extent. In August, borrowings at the Reserve Bank were slightly higher than in the preceding month. They were still running about one-third of a year ago, with the recent increase primarily in borrowings by country banks.

Mr. Erickson said that as to the money supply he wished to associate himself with the views expressed by Mr. King. As to policy for the next three weeks, he would not change the directive or the discount rate, and he would give the Account Manager the same instruction as at the August 16 meeting. This would mean proceeding on the basis of the feel of the market and supplying a few more reserves, not overdoing it but supplying reserves as needed.

Mr. Szymczak suggested that business uncertainties over a period of time, the actions on margin requirements, vault cash, reserve requirements, and the discount rate, the special session of Congress, the election campaign, the announcement of advance refunding, the pluses and minuses in the economy, and the number of changes on the minus side all had contrived to produce a situation that reflected itself in the present figures on credit as well as rates. He felt that on the whole System operations had been good. He felt also that, as Mr. Mills had said, there were so many intangibles that no action on the part of the Federal Reserve with respect to reserves and rates or anything else was likely to change the situation. Too frequently, he commented, there is a tendency to become convinced that monetary policy can do the whole job. Actually the System had done the best it could, and in his opinion it could not have done much better. As and when possible the System should add to the availability of reserves, but this should not be overdone. While there were minuses in the economy, there was also evidence that the economy might be firming somewhat. While it was not likely to be pushed up substantially, he doubted whether it would continue to move downward.

On balance, Mr. Szymczak said, he would continue to do exactly what the Committee had been doing. He would not want too much tightness to develop in the market. Accordingly, he would not look too much to statistics, but rather be guided primarily by the feel of the market, with just a little more free reserves, perhaps, than during the past few weeks. He would not recommend any change in the directive.

Mr. Balderston referred to the sideways movement of the economy on a high plateau for a substantial period and said he rather supposed that downward forces would gradually prevail. He had been looking for some signs of activity in residential building and plant construction. As to the first, about the only information he could find of a comforting nature was that the Veterans Administration had experienced some increase in applications recently. Insurance company executives told him that the authorized rate apparently reached a peak in June, with some slight recession and lowering of the rate since that time. However, he did not expect an upsurge in residential construction because of the demand situation, and he did not think that pumping credit into that industry would offset the slackening demand for houses at present prices. As to plant expenditures, he thought that when the most recent figures were released by the National Industrial Conference Board they would show a further slackening in budget authorizations. He did not feel that for some months to come companies would be increasing their plants or even adding to labor-saving equipment at the rate that was thought probable, and he would suppose that the economy would gradually drift lower. That meant having to be fully aware of the adverse balance of payments and the views concerning that situation that were held both here and abroad. Therefore, he was rather pleased that the bill rate had held where it did for the past few weeks.

Mr. Balderston said he found himself generally in sympathy with the views of those who had spoken toward the end of the discussion this morning. He felt Mr. Szymczak was correct in expressing the view that it was not possible just to turn a valve. What he would suggest would be not to attempt to mop up all of the float that was likely to become available within the next couple of weeks. Otherwise, he would sit as steady in the boat as possible and let what the System had attempted to do for the economy work in for a while. The horse that the System was trying to make drink apparently was not very thirsty.

Chairman Martin, who had just returned from a vacation abroad, said that he thought Federal Reserve policy had been quite good. With regard to the progress that the System had been making, it was his personal feeling that one should look with some skepticism on the statistical estimates. When considering the money supply, one must think in terms of what was really happening in the economy. The fundamental question was whether there was any real shortage at the present time of money that would contribute to business confidence and improvement, and he doubted whether there was any shortage in that sense. Mr. Mills had put his finger on the matter when he said that there comes a point when one cannot expect monetary and credit policy to do the entire job. The System must not take itself too seriously in this field.

The Chairman said it was his impression that the moves of the System thus far had been received surprisingly well. Though perhaps not perfect, they had been timely, and they had been accepted with a minimum of charges about their having been political in content or motivated by wrong reasons. From here on out, however, the System must be careful that it did not make moves that would be subject to political observations and comment.

Chairman Martin went on to say that he had returned from his vacation without any feeling of confidence concerning the balance of payments. Mr. Marget, he felt, had perhaps been straining just a little in his statements this morning and at the August 16 meeting, not with respect to the facts but with regard to the interpretation that might be placed on the facts. It seemed to him that the United States was priced out of the market in a good many areas, while at the same time there had been an additional accumulation of dollars by foreigners. No one who had not been abroad recently could appreciate the size and extent of the boom in Western Europe, and to some extent this was contributing to the favorable United States trade balance because people were willing to buy at any price in order to obtain deliveries.

Continuing, the Chairman commented that foreigners were watching the United States carefully. He felt that confidence in the dollar had thus far been maintained; that the Treasury program, the budget surplus, and Federal Reserve policy, taken together, had reestablished confidence in the dollar on the part of most foreigners who were thinking about the subject. Their first worries about the dollar had come with the lowering of the discount rate in June, the political campaigns, and the appearance that the country might be embarking on a cheap money policy that would have no relationship to the business situation itself. As of today, however, it seemed to be accepted generally that the steps taken thus far were reasonable ones, although foreigners were continuing to watch the situation carefully to see whether panic would develop and a cheap money policy would be instituted as a device to try to alter the business situation. Foreigners recognized the situation as one in which rolling adjustments had to be made, particularly adjustments in prices, if market demands again were going to be established. In part, those adjustments were postponed by the easy money period in 1958 when in his (Chairman Martin's) judgment the System went too far. He did not think the System would want to repeat that course for the sake of a few kudos from the easy money people who were not going to be friendly in any event.

Chairman Martin said he came out in his thinking that doubts should be resolved on the side of ease and reserves supplied whenever they could be supplied in an orderly way and would be used. However, it is not possible to make a horse drink if it does not want to drink.

The Chairman then repeated that in his opinion certain adjustments were going to have to be made in the economy. It was rather surprising, with adjustments going on and with shrinking profit margins, that there had not been more of a decline in the industrial production index. Considering that steel and automobiles had not done as well as expected, either as to sales or production, the showing of the index was quite impressive. By this he did not mean to suggest that he thought the country was facing a business upswing of any size; indeed, he was inclined to be somewhat pessimistic about the business picture, more so than several months ago. He was pessimistic, however, only in the sense that he feared people might get panicky and try to push too hard on the string when what was needed was just a little steadiness in the boat and recognition that there must be some adjustments. Where price adjustments had taken place, they unquestionably had been generating some demand, but the situation, of course, was painful for those concerned. In this connection Chairman Martin recalled an observation he had heard abroad that if the steel industry would get into the European market actively, even if it took slight losses on some items, it would be doing a great service to European industries at the present time. Those industries were expanding at a faster pace than could possibly be sustained and were experiencing an amazing demand on all sides, but the United States had priced itself out of the market on some items.

Chairman Martin again expressed the view that it would be advisable to remain fairly steady in the boat and that moves from here on out should be largely in the nature of supplying reserves as needed rather than dramatic overt actions. He reiterated that he felt the System had done a good job of establishing a proper posture and taking a series of steps that were understood. Several foreign observers to whom he talked informally had expressed the view that a 2 per cent bill rate, a 4-1/2 per cent prime rate, and a 3 per cent discount rate could be lived with, but a bill rate below 2 per cent was something they thought would have serious repercussions on thinking abroad. In his view, until after the elections the System should minimize overt actions unless it was positive that such actions were important from the standpoint of the economy, for actions of that kind could easily be misunderstood on all sides. He felt the System had been wise to move as early as it did, and under conditions such as to give credence to those moves which, up to this point, he did not think had been challenged seriously by thoughtful people.

All of these things, the Chairman said, must be borne in mind in thinking of the money supply. The System must not let itself be persuaded that if it had expanded the money supply in exactly the right amount on a statistical basis, there would not have been any recession. That was what some critics of the System had been arguing for many years. If it got to that point, the only thing necessary would be to keep the levers moving ad infinitum.

The Chairman again mentioned the fact that rolling adjustments are painful. At a previous meeting, he recalled, he had referred to losses in securities and to the difficulties involved in taking losses of that kind. Now there were shrinking profit margins in business and the world competitive picture was tightening. Also, the fact that underemployment was one of the most serious weaknesses in the economy today tended to make for uncertain economic thinking and to put the matter into purely a social perspective. However, unless totalitarian methods were going to be adopted, and if reliance was going to be placed on market processes, it must be recognized that there had to be adjustments from time to time and that employment would not be created merely by avoiding the losses or the adjustments that were necessary.

Chairman Martin then said that the discussion at this meeting seemed to indicate a clear consensus in favor of no change in the policy directive. It also appeared to be the consensus that open market operations should be directed generally toward maintaining an even keel during the period of Treasury financing, but that doubts should definitely be resolved on the side of ease and that, as at the August 16 meeting, emphasis should be placed on giving the Manager of the Account wide latitude to supply reserves as he saw fit according to the tone of the market rather than the statistical movement of reserves.

The Chairman inquired whether there was any question regarding this summarization of the general view of the meeting, and there were no comments.

Thereupon, upon motion duly made and seconded, it was voted unanimously to direct the Federal Reserve Bank of New York, until otherwise directed by the Committee:

(1) To make such purchases, sales, or exchanges (including replacement of maturing securities, and allowing maturities to run off without replacement) for the System Open Market Account in the open market or, in the case of maturing securities, by direct exchange with the Treasury, as may be necessary in the light of current and prospective economic conditions and the general credit situation of the country, with a view (a) to relating the supply of funds in the market to the needs of commerce and business, (b) to encouraging monetary expansion for the purpose of fostering sustainable growth in economic activity and employment, and (c) to the practical administration of the Account; provided that the aggregate amount of securities held in the System Account (including commitments for the purchase or sale of securities for the Account) at the close of this date, other than special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury, shall not be increased or decreased by more than $1 billion;

(2) To purchase direct from the Treasury for the account of the Federal Reserve Bank of New York (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed in the aggregate $500 million.

It was agreed that the next meeting of the Federal Open Market Committee would be held in Washington on Tuesday, October 4, 1960.

Chairman Martin then referred to a memorandum from the Federal Reserve Bank of New York dated September 8, 1960, copies of which had been distributed to the members of the Committee with a memorandum from Mr. Young dated September 12, 1960, recommending that the Bank's Market Statistics Department be authorized to furnish to the Securities Department quarterly statistics on the volume of individual Government securities dealers. The Chairman stated that he proposed to put this matter down for discussion at the next Committee meeting, but that Mr. Hayes or Mr. Rouse might want to make some comment at this time.

Mr. Hayes stated that the New York Bank was trying to cover in this memorandum what seemed to have been a minor oversight in the ground rules set up in connection with the establishment of the Market Statistics Department. The Bank felt that it would be appropriate and useful for officers of the Securities Department to have quarterly past figures on volume for the sake of maintaining an adequate understanding as to who the real dealers were. It was important for the Securities Department to have this yardstick since the Bank was called upon to supply the Treasury with a list of primary dealers for the use of national bank examiners, and since decisions had to be made as to whether new firms that desire to deal with the Account are in fact dealers. He felt that the dealers would not raise any serious objection.

Mr. Young said that possibly this suggestion raised some questions about the Committee's earlier action with regard to the recognition of dealers. This was to be on the basis of whether they were actually engaged in the business, but no criterion was established at the particular time. This also involved the question of System transactions with particular dealers, which were to be on the basis of price alone, except that the dealers presumably would be reputable parties. Now the Committee would be moving through that kind of approach into something else as a basis for determining whether a person was or was not a dealer. As to whether or not there would be any objection to the current proposal, some objection had been encountered earlier to the ground rules that were set up for the market statistics program, and this would involve going back to the dealers. In his opinion, there was a question whether it would be advisable to go back and enter into further negotiations with them at this particular time. There had been discussion of this matter at one of the luncheons with the Treasury a week or so ago, and the inclination at that time was to feel that renegotiations at this particular time would be undesirable, that it would be advisable for the statistical program to move along and to have some publications started before raising any further questions. From comments that had been made at one time, it appeared that there might be at least one dealer who would interpose an objection.

Mr. Young noted that there was contained in the New York memorandum a statement that the Treasury had approved the current suggestion. It was true that the Treasury did write a letter indicating approval, but he did not know whether the Treasury had taken any further position. The position expressed at the luncheon to which he had made reference was to the effect that the Treasury saw some reasons for objecting, but did not feel that the reasons were essential in terms of their own interests.

Mr. Rouse commented that he had discussed the matter with Under Secretary of the Treasury Baird when he was in Washington last week in connection with conferences on the advance refunding and that as far as the Treasury was concerned he understood there was no objection.

Mr. Shepardson noted that the Market Statistics Department had been set up for the purpose of providing a separation of functions and gathering needed information. He inquired why it would not be possible for that Department to do the job indicated in the memorandum and thereby avoid breaking down the separation of functions.

Mr. Rouse replied that the Department would have no judgment at all about such a matter. It did not know the market, he said, and it was not set up for that purpose.

Mr. Hayes said he thought it had been recognized by all concerned that the real knowledge of the market, when it came to deciding who were dealers and who were making primary markets, resided in the people working with the dealers in market activities. The Market Statistics Department was not doing that; it was collecting statistical figures from the dealers, but had no contact with them otherwise. In any event the Securities Department would not have current figures on statistical positions such as conceivably might lead to the charge that the Desk could use that knowledge against the dealers, and that was the purpose of the separation of functions. The situation would not be affected by giving the Securities Department statistics on past volume; that would not enable the Desk to trade against the dealers today.

Mr. Shepardson inquired why the Market Statistics Department could not give the Desk a list of people who met the criteria, without providing information on individual volume, to which Mr. Rouse replied that it was difficult to imagine how the Department could do it. He added that it was his understanding that the objections from the standpoint of the dealers had been in terms of giving information to others than the officers of the New York Bank. The objections were directed more to the Treasury and Washington generally having access to individual dealer figures. The Securities Department ought to have these figures to function effectively, and as he understood it the only objection to the Desk having figures both on volume and position was made by the Lanston firm. In that connection, he had heard that officers of that firm did not share Mr. Lanston's views.

Mr. Young commented that the matter would have to be put up to them, for he did not know what views might be held.

In response to a question as to why the Securities Department could not collect the statistics directly, Mr. Hayes said that this had been the procedure for many years. The separation of functions was undertaken only on the initiative of the Committee.

Chairman Martin then stated that the matter would be taken up for further consideration at the next meeting of the Committee.

Mr. Hayes stated that he would like to make a further comment for purpose of clarification. While he shared the feeling that one had to be skeptical about the money supply and reserve figures, in view of some of the discussion today he wished to point out that in August there was an increase in total reserves and also in required reserves. Although total reserves in August were somewhat below August 1959, the big drop occurred between January and April. It was about the latter date that the Committee got serious about trying to loosen things up, and total reserves, seasonally adjusted, had risen from the April figure of $18,104 million to $18,450 million in August. Likewise, nonborrowed reserves had risen from $17,410 million in April to $18,230 million in August. In terms of annual rates of gain, total reserves had risen 6 per cent from April, nonborrowed reserves 14 per cent, and required reserves 7 per cent. One could look at the figures in many different ways, but in his view there had been progress in recent months.

The meeting then adjourned.

Ralph A. Young

Secretary